

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Competitive Product Prices
Inbound Competitive Multi Service Agreements
With Foreign Postal Operators
Canada Post Corporation—United States Postal Service
Bilateral Agreement (MC2011-34)
Negotiated Service Agreement

Docket No. CP2012-4

PUBLIC REPRESENTATIVE COMMENTS ON
POSTAL SERVICE NOTICE OF FILING AN ADDITIONAL
NEGOTIATED SERVICE AGREEMENT FOR INCLUSION WITHIN
INBOUND COMPETITIVE MULTI-SERVICE AGREEMENTS
WITH FOREIGN POSTAL OPERATORS 1

(December 23, 2011)

The Public Representative hereby provides comments pursuant to Order No. 1057.¹ In that Order, the Commission established the above referenced docket to receive comments from interested persons, including the undersigned Public Representative, on the Postal Service's notice of its entry into an additional Inbound Competitive Multi-Service Agreement with a foreign postal operator.² The Notice concerns the inbound portion of a bilateral agreement with the Canada Post Corporation (Canada Post 2012 Agreement) to be included within the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product. Notice at 1.

The Canada Post 2012 Agreement establishes prices and classifications for the delivery of inbound Air Parcel Post (Expedited Parcels USA) and Express Mail Service (EMS) in the United States. *Id.* at 4. The Agreement is intended to become effective January 1, 2012, and remain in effect for two years unless terminated sooner. *Id.*

¹ PRC Order No. 1057, Notice and Order Concerning Bilateral Agreement With Canada Post Corporation, Negotiated Service Agreement, December 19, 2011.

² Notice of United States Postal Service of Filing Functionally Equivalent Inbound competitive Multi-Service Agreement with a Foreign Postal Operator, October 17, 2011 (herein "Notice").

Previously, in Order No. 546, the Commission approved the Inbound Competitive Multi-Service Agreement with Foreign Postal Operators 1 product, and the addition of an agreement with Koninklijke TNT Post BV and TNT Post Pakketservice Benelux BV (TNT Agreement) within the product.³ The Commission subsequently approved the addition of bilateral agreements with the China Post Group (China Post 2011 Agreement), Posten Norge AS (Norway Post Agreement) and the Australian Postal Corporation (Australia Post Agreement) within the Inbound Competitive Multi-Service Agreement with Foreign Postal Operators 1 product.⁴ In Order No. 840, the Commission accepted the Postal Service's designation of the TNT Agreement as the baseline agreement for purposes of determining whether future agreements are functionally equivalent.⁵

In this proceeding, Chairman's Information Request (CHIR) No. 1 seeks additional information concerning use of industrialized country (excluding Canada) unit costs rather than Canada-specific unit costs or industrialized country unit costs that include Canada in the calculation of the cost of inbound EMS from Canada, and adjustments to inbound volumes.⁶ The Postal Service's response to CHIR No. 1 is due no later than December 27, 2011. *Id.*

COMMENTS

The Public Representative has reviewed the Canada Post 2012 Agreement and the supporting financial model filed under seal that accompanies the Postal Service's Notice. Based upon that review, the Public Representative concludes that the Canada Post 2012 Agreement is functionally equivalent to the baseline TNT Agreement.

³ PRC Order No. 546, Order Adding Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 to the Competitive Product List and Approving Included Agreement, Docket Nos. MC2010-34 and CP2010-95, September 29, 2010.

⁴ See PRC Order No. 859, Order Concerning An Additional Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 Negotiated Service Agreement, Docket No. CP2011-68, September 16, 2011; see also PRC Order No. 840, Order Concerning An Additional Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 Negotiated Service Agreement, Docket No. CP2011-69, September 7, 2011; and PRC Order No. 956, Order Concerning An Additional Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 Negotiated Service Agreement, Docket No. CP2012-1, November 9, 2011.

⁵ PRC Order No. 840, at 5.

⁶ Chairman's Information Request No. 1 (CHIR No. 1), December 21, 2011.

However, the Agreement may not satisfy the requirements of 39 U.S.C. § 3633. The financial model relies on unit costs that are unrelated to Canada. The financial model also deviates from the TNT financial model. Nevertheless, the Canada Post 2012 Agreement covers its attributable costs and exceeds the required minimum cost coverage applicable to the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators product established by the Governors.⁷

Functional Equivalence. The Postal Service asserts that the “Canada Post Agreement is substantially similar to the inbound portion of the TNT and Australia Post Agreement in terms of the products being offered under the contract and the contract’s cost characteristics.” Notice at 5. In this regard, one similarity includes “pay-for-performance” measurement and compensation for inbound Air Parcel Post and EMS.

The Postal Service identifies some differences between the Canada Post 2012 Agreement compared to the TNT and Australia Post agreements. These differences include more detailed provisions concerning the consequences of early termination (Article 22) and the processes to be used to protect Canada Post’s confidential information when filed in regulatory or other proceedings in the United States (Article 13). *Id.* The Postal Service maintains that although the former difference could possibly impact cost characteristics in comparison to other agreements in the product, that impact could be positive because the more detailed termination clause “eliminates substantial risks concerning the rates following the termination that would otherwise accompany the Agreement.” *Id.* at 6. The Postal Service also maintains that the more detailed provision concerning confidential information does not affect either the market or cost characteristics of the Agreement. *Id.* The Public Representative agrees that these differences do not alter the conclusion that the Canada Post 2012 Agreement is functionally equivalent to the baseline TNT Agreement.

Requirements of 39 U.S.C. § 3633. Pursuant to 39 U.S.C. § 3633(a), the Postal Service must demonstrate that the Inbound Competitive Multi-Service Agreement with

⁷ See Request of United States Postal Service to Add Inbound Competitive Multi-Service Agreements with Foreign Postal Operators to the Competitive Product List, and Notice of Filing (Under Seal) of Enabling Governors’ Decision and Negotiated Service Agreement, Docket Nos. MC2010-34 and CP2010-95, August 13, 2010, Attachment 2.

Foreign Postal Operators 1 product covers attributable costs, which precludes the subsidization of competitive products by market dominant products and thereby makes an appropriate contribution to the institutional costs of the Postal Service. With respect to other competitive products, the Commission has determined that additional individual agreements may be included within a product if they are functionally equivalent to the previously submitted baseline agreement for the product and they meet the requirements of 39 U.S.C. § 3633.⁸

In this proceeding, the Postal Service's financial model does not demonstrate that the addition of the Canada Post 2012 Agreement results in the Inbound Competitive Multi-Service Agreement with Foreign Postal Operators 1 product covering costs as required by 39 U.S.C. § 3633. However, the Postal Service's financial model does indicate that the negotiated prices in the Agreement will cover costs, and therefore will not degrade the cost coverage of the product.

That said the Postal Service's financial model deviates from the financial model accompanying baseline TNT Agreement in order to produce a cost coverage that satisfies the requirements of section 3633(a) and the minimum cost coverage approved in Governors' Decision No. 10-3. The financial model accompanying the baseline TNT Agreement includes a "contingency" factor that is applied to mail processing, delivery, transportation and other cost estimates and provides for unknown developments during the contract period.⁹ Such developments include unfavorable exchange rate fluctuations and other misestimates of costs.¹⁰ With respect to the financial model for Canada Post 2012 Agreement, the Postal Service has selected a smaller contingency factor compared to the factor in the TNT financial model.¹¹ This smaller factor contributes to a more favorable cost coverage.

In addition, the financial model uses mail processing unit costs for industrialized countries (excluding Canada) in developing the total costs of inbound EMS rather than

⁸ See PRC Order No. 601, Order Approving Five Additional Global Expedited Package Services 3 Negotiated Service Agreements, Docket Nos. CP2011-34, CP2011-35, CP2011-36, CP2011-37 and CP2011-38, December 1, 2010, at 5.

⁹ Excel file (Non-Public) Netherlands_Comp_IB_2010.09.22.xls, worksheet tab 01_Inputs.

¹⁰ *Id.*

¹¹ Excel file (Non-Public) Canada_Bilateral_Comp_Inbound_2011.10.28_v3.xls, worksheet tab 01_Inputs.

the Canada-specific mail processing unit costs presented in the FY 2010 International Cost and Revenue Analysis (ICRA) report.¹² The effect of doing so is to produce a more favorable cost coverage compared to the cost coverage based upon Canada-specific (or the industrialized countries including Canada) EMS mail processing unit costs. CHIR No. 1 requests the Postal Service's rationale for using industrialized country (excluding Canada) unit costs.

Although the Public Representative considers the estimated cost coverage to be compliant with section 3633(a), that estimate depends heavily upon the reliability of the estimate of costs. A relatively small estimation error could result in higher costs, causing revenues under the Agreement to not cover costs. Moreover, the use of a smaller contingency than the TNT financial model and EMS processing unit costs unrelated to Canada that produce a more favorable cost coverage are problematic. The Commission has previously expressed concern about the Postal Service's cost and revenue estimates that adversely affect contribution (and cost coverage) for EMS service.¹³ These concerns are also applicable to the Canada Post 2012 Agreement and suggest that the Agreement may not cover costs.

The Public Representative respectfully submits the foregoing comments for the Commission's consideration.

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¹² Library Reference USPS-FY10-NP2, Docket No. ACR2010 Dec. 29, 2010, as revised by Letter to the Commission, dated April 26, 2011.

¹³ Annual Compliance Determination, FY 2010, Docket No. ACR2010, March 29, 2011, at 147.